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Research Article

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What can institutional analysis say about capitalism in Central and Eastern Europe? Results and limitations

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Abstract: A growing literature examines institutional arrangements in Central and Eastern European (CEE) market economies. Some sources claim that there is a distinct model of capitalism in this region. This paper overviews and analyzes the results of these studies in connection with crucial methodological issues showing the limitations of institutional analysis. Despite all methodological difficulties, with a combination of different methods, institutional comparison is able to provide essential insights into the position and future prospects of CEE member states. One of the most important insights is that the maintenance of economic convergence to Western European countries requires substantial institutional changes. This paper also suggests that a broader historical context can help to evaluate opportunities and the risk of path dependency. It seems fruitful if the current development is fit into the conceptual framework which conceives of CEE as the region of "in-betweenness," where the legacy of incomplete modernization attempts hinders the optimal institutional arrangement.

Keywords: institutional comparison, Central and Eastern Europe, varieties of capitalism
JEL code: P16, P51, B41

1 Introduction

Institutional analysis has been generally accepted as a necessary way of understanding socioeconomic development. There are several studies in the literature which use this methodology in the investigation of the transition from a socialist to a capitalist system and the stabilized institutional arrangement of post-socialist countries. This paper examines how institutional analysis can contribute to the understanding of the current position and future perspectives of Central and Eastern European (CEE) countries which are European Union (EU) member states and also to what the limits of institutional analysis are.

This paper is structured as follows: in the first section, the importance of the theoretical framework is highlighted. In the second section, different interpretations of CEE models of capitalism are outlined. The next section suggests that the broader interdisciplinary context enhances the results of analysis. The conclusion summarizes the lessons of the institutional investigation of the CEE region for future research.

2 Importance of the theoretical framework

Institutional research was an almost forgotten topic after World War II. In the 1970s, the quick catching up of some small Western European countries aroused some interest in institutional comparison. A distinct field of interest was the system comparison between capitalism and socialism. Despite the collapse of socialist

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systems, two different fields of research survived. One of them addresses the issues of developed countries, and the other investigates the transformation of socialist countries. This section discusses two examples to highlight how crucial the choice of theoretical framework is for institutional analysis.

In 2001, Hall and Soskice launched a new approach in the institutional analysis of developed countries. In the introduction of the selected volume titled "Varieties of Capitalism" (VoC), they described a new theoretical framework. They classified the institutional arrangement of capitalism focusing on the relationships of firms in the most important parts of economies (corporate finances, industrial relation, vocational training, etc). They identified two ideal types: liberal and coordinated market economies. The USA embodies the liberal market economy, Germany the coordinated market economy. This dual classification is the starting point of the branch of institutional comparison which is known as VoC.

Their undertaking was very successful and accepted in the literature. It happened despite the fact that their basic idea, dual classification, has been univocally debated and criticized. We have to add that Hall and Soskice [2001] mentioned that the Mediterranean countries may form a distinct type of capitalism, but this idea has got no significance in their theory.

Several authors are not satisfied with dual classification, because they believe that more models are able to embrace the institutional settings of contemporary market economies. The aim of this study was not to give a comprehensive overview, but only to introduce some examples of criticism. Hay [2005] pointed out that the reason for the dual classification is unfounded. It is not explained why they are not distinguished, for example, the continental, the Nordic countries, and so on. In the comparison of Germany and the USA, the liberal market economy seems to be a system of weak institutions, whereas it is not the case but the way of coordination is different. Pontusson [2005] highlighted that Japan does not comply with the description of coordinated market economy. Furthermore, Great Britain, with its developed welfare system, cannot be identified with liberal market economy. Crouch [2005] said that the institutional systems of France and Great Britain do not support dual classification. Moreover, Crouch called into question the foundation of the model of liberal market economy. In the USA, the military sector is the main driver of innovations that has a huge influence on the achievement of economy. Amable [2003] claimed that one element of institutional systems, coordination, cannot be the sufficient basis of classification. The fact that many cases do not fit in the two models requires a more complex classification. This list of criticism indicates the serious problems of dual classification.

Mjøset and Clausen [2007] revealed a new dimension concerning dual typology, which are the problematic issues of methodology used by Hall and Soskice [2001]. The usual ways of modeling in theoretical works are either empirical theory building based on data collection or creation of mathematical model based on abstract assumptions. In the opinion of Mjøset and Clausen [2007], Hall and Soskice combine these elements of the two methodologies and it is not an appropriate solution. On the one hand, they used the terms of game theory, and this way they connected microeconomics with macroeconomics. This method refers to abstract model building. On the other hand, they identified the models of liberal and coordinated market economies with concrete countries such as the USA and Germany. However, the abstract models cannot be related to empirically established cases. Crouch [2005] pointed out that models have to be built on theoretically grounded features, and in concrete cases these features can be identified partially.

Several authors use plural classification to identify models of capitalism. By the end of the 1990s, there was a growing consensus among the researchers of institutional comparison that the old EU member states could be typified by four models (the Anglo-Saxon, the Nordic, the continental, and the Mediterranean), which are complemented by Asian model in some studies. It was Bruno Amable who conducted the most comprehensive research suggesting a taxonomy of market-based, continental European, social democratic, Mediterranean and Asian models in his book "The Diversity of Modern Capitalism" in 2003. He outlined a well-founded theoretical framework and avoided methodological unilateralism. He combined methodological individualism and game theory with the idea of bounded rationality, and he considered social conflicts and the politico-economic aspects. In addition, he carried out more thorough empirical investigation than the other authors. Amable's study had got very few critical comments, remarks, and a lot of citations.

Despite the above-listed problems, dual classification has become widespread. Perhaps the simplicity was attractive; perhaps the 2-year advantage in relation to Amable's work had an impact. The research questions of Hall and Soskice [2001] addressed the achievement and institutional settings of (the most) developed economies, and this simplified approach was sufficient to answer their questions – but it had unintended consequences. The Mediterranean countries received little attention, and the analysis of their institutional arrangement remained in the shadows. The investigation could have revealed that catching up was less stable and successful than the precrisis macroeconomic indicators suggested. Of course, this kind of investigation could not have prevented a euro crisis, but the problems would not have been so unexpected, and crisis management could have been more efficient. Since the 2008 global crisis, several studies have highlighted the impact of different institutional settings in the euro zone. In his recent article, Hall [2018] acknowledged the significance of the distinct Mediterranean model. Summarizing the literature, he stated: "[b]ased on these observations, it should be apparent how variations in European capitalism contributed to the euro crisis" [Hall, 2018, p. 13].

Many researchers used the dual classification as a starting point in the examination of post-socialist countries [e.g., Buchen, 2007; Feldmann, 2007; King, 2007; Knell and Srholec, 2007; Lane and Myant, 2007; Mykhnenko, 2007; Blanke and Hoffmann, 2008], looking for similarities to liberal and coordinated market economies. Nölke and Vliegenhart [2009] accepted the dual classification for developed countries but they claimed that a new model of capitalism has emerged, which they termed as "dependent market economy", with, however, their investigation covering the Visegrád countries only. They prepared a well-founded critique of the attempts to classify post-socialist countries in two models of liberal vs. coordinated market economies and revealed very important features of these economies. These researchers explained all characteristics of dependent market economies from the outstanding role of foreign capital. The term "dependent market economy" has become widespread. However, simplification may be misleading also in this case. The outstanding role of one element, foreign capital, hides the fact that the real relation between capital exporters and CEE countries is asymmetric interdependency rather than dependency. As the case of Hungary has indicated since 2010, although Viktor Orbán is the Prime Minister of a capital receiver country, he could strengthen his position due to the asymmetric but mutual dependency between the capital exporter Western European and the capital importer CEE countries. The conflicts over migration between Western and Eastern EU member states since 2015 and the relation between Germany and the Visegrád countries in the Central European manufacturing core can also be interpreted in the framework of asymmetric interdependency.

The examples of the Mediterranean model and dependent market economy show that it is a very difficult task to find the appropriate level of abstraction. The simplicity, the parsimony of a model, is very attractive, and it may be fruitful to put the emphasis on some crucial connections. However, a too general theoretical framework can hide problems of vital importance. As given in the next section, the combination of various methods can mitigate the risk of error.

3 The model of capitalism in CEE

3.1 Model as an institutional arrangement

Before the examination of the CEE model of capitalism, it must be outlined how the term "model" is used. In the literature, this term is used in different fields, e.g., it refers to the institutional arrangement at the macroeconomic (national) level, like the models of coordinated market economy and Mediterranean market economy or to the combination of an institutional arrangement and an economic policy toolkit as a growth model or to special fields such as models of wage setting, etc.

In this paper, the model of capitalism means the institutional arrangement of the socioeconomic system which has decisive impact on the economic performance and competitiveness of a country. In VoC theory, institutional complementarity is a basic idea which explains that various institutional settings do not converge entirely on a liberal market model. Hall and Soskice [2001, p. 16] claimed that "two institutions can be said to be complementary if the presence (or efficiency) of one increases the returns from (or efficiency of) the other." Firms and governments can utilize the institutional complementarities which are already present in the economy in order to reach the efficiency gains ensured by such complementarities. Moreover, if the actors recognize these complementarities, they may try to preserve institutional arrangements in one sphere so as to ensure the efficiency gains they provide when combined with the institutions present in another sphere of the economy. The presence of institutional complementarities may act as a disincentive for radical change [Hall and Soskice, 2001].

This approach implies that the drive of institutional selection and complementarities is utility optimization. It may be meaningful if one compares the different institutional patterns of the two countries, the USA and Germany, which belong to the most competitive economies and are at the technical frontier. However, if we extend the investigation to less developed countries, utility optimization cannot explain institutional selection and complementarities. It seems that the assumption of sustainability is enough to understand the institutional complementarities. An institutional setting can exist as a model if it can reproduce itself, that is, if it is sustainable.

Institutional arrangement changes over time, and hybridization is a very characteristic feature of the globalized world. It is a severe theoretical challenge to define the elements which identify an institutional arrangement as a model and to determine the changes which already alter the model to another one.

3.2 Institutional arrangement in CEE

The economies of CEE which have been integrated in the EU are investigated from various viewpoints such as macroeconomic or institutional. In the framework of both approaches, many reasonable research topics emerge, e.g., competitiveness, catching up, regional and national differences, etc. This paper focuses on the institutional approach and on the choice of appropriate methods, which depends on the research question.

Bohle and Greskovits [2012] represented a special strand of research, and they built their study on Karl Polányi's theoretical concept on great transformation. They were interested in the relationship between the free market system and the social forces which oppose the subordination to market forces. Their analysis was based on the comparison of detailed and thorough case studies. They claimed that after the systemic change, three versions of capitalism can be distinguished in CEE: a purely neoliberal type in the Baltic states, an "embedded" neoliberal type in the Visegrád countries, and a neo-corporatist system in Slovenia. When discussing the three versions, they examined welfare state and labor relations, industrial structural change, macroeconomic stability, and political systems. The authors considered the specific characteristics of the socialist legacies and, taking these as a starting point, they overviewed the development of the models from a historical point of view. Furthermore, they integrated the impacts of the EU and the transnational companies in their study.

Other studies classify the CEE countries' institutions to understand and explain their economic performance. As mentioned earlier, the attempts to identify the CEE institutional setting with liberal or coordinated market economies one decade ago were thoroughly criticized by Nölke and Vliegenhart [2009], and it is not necessary to repeat their criticism. Surprisingly, Hall [2018] still classified the CEE countries as a subgroup in the group of liberal market economies. It is not only strange to read Hungary and Slovenia in the list of liberal market economies, considering their economic policy, but this term also does not fit the others. Hall and Soskice [2001] introduced as the essential feature of the institutional arrangement of liberal market economies that it provides firms with better abilities for radical innovation. The innovation systems of CEE countries are very far from radical innovation. Their bank-based financial system is also different from the liberal ideal type. If one accepts the original concept of VoC theory, the model of liberal market economy means much more than conducting liberal economic policies in some fields.

Ahlborn et al. [2016] applied an extended VoC framework to examine the CEE countries' systemic transformation in the Organization for Economic Cooperation, and Development (OECD) context. They measured government activities and economic performance with six indicators. They identified the well-known Nordic, liberal, Mediterranean, and continental models. The CEE countries form two clusters termed as CEE liberal market economies (Baltic states, Bulgaria, Romania, and Slovakia) and CEE coordinated market economies (Croatia, Czech Republic, Hungary, Poland, and Slovenia).

The third line of research, represented by Farkas [2011, 2016], Próchniak et al. [2016], Rapacki and Czerniak [2018], follows the complex, empirically based system analysis launched by Amable [2003]. These studies used a wide range of indicators (from 40 to 130) to cluster the socioeconomic subsystems (production markets, labor markets, innovation systems, etc.) of the CEE countries in the EU context. Although they applied different methods of measurements and different (pre- and postcrisis) data, the examinations indicate the CEE countries as a distinct model even if there are very substantial differences among them. It is also noteworthy that these studies reveal a division in institutional arrangements between Northern and Western vs. Eastern and Southern countries rather than between old vs. new member states.

How can these results be assessed to decide whether a distinct model of CEE capitalism exists? In institutional comparison, the classification of countries always expresses relative similarities and differences. On the one hand, Bohle and Greskovits [2012] discovered the differences and created groups among the CEE countries and did not address their comparison with Western European models of capitalism. On the other hand, although Farkas [2016], Próchniak et al. [2016], Rapacki and Czerniak [2018] claimed that a distinct CEE model can be outlined in the EU, they strongly emphasized the differences within this model. There are methodological issues which underpin the suitability of the latter approaches.

The choice of statistical data requires special circumspection if one wants to grasp the characteristics of institutions. Using some examples, Pontusson [2005] demonstrated that some small changes in indicators can lead to adverse conclusion that whether coordinated and liberal market economies converge or diverge in their institutional arrangements. Measuring inequality, the results are also dependent on applied indicators. The comprehensive comparison of systems based on many indicators decreases the danger that the small number of indicator distorts the results.

One of the sensitive points of comparative analyses is the fact that the choice of investigated elements for the models of capitalism is not supported by theoretical arguments. In addition, even if the values of indicators are similar, it does not mean that the institutions which are described by these indicators are also similar. The above-cited studies on the model of CEE capitalism seek to avoid these pitfalls, and they establish their choice of indicators.

However, there is a general problem of empirical investigation in institutional comparison which cannot be solved. Hall [1999] and Hall and Gingerich [2004] warned that the number of cases is so small that it makes impossible empirical testing that meets strict statistical requirements. Therefore, the results of quantitative analysis should be controlled by qualitative studies, as Farkas [2016] had done.

Considering not only institutional comparison but also macroeconomic investigations, we can outline the model of CEE capitalism. It is generally accepted in the literature that the special feature of this region (comparing to other emerging economies) is the outstanding role of foreign direct investment (FDI) in modernization [e.g., Gill and Raiser, 2012] which inspired Nölke and Vliegenhart [2009] to call the institutional arrangement of Visegrád countries as dependent market economy. The studies written at the European Trade Union Institute emphasize the low level of wages and name the CEE institutional setting as a low-wage model [Galgóczi and Drahokoupil, 2017].

Being catching-up countries with the lack of capital and management knowledge, the CEE countries adopted different institutions during the capitalist transformation which are similar to different types of capitalism. This means that, on the one hand, their complementarity cannot be explained as a result of utility optimization. On the other hand, the elements of this institutional arrangement have an inner logic, a “suboptimal” complementarity which suggests that the model is sustainable. The relatively cheap but skilled labor attracted FDI. However, this situation can be maintained if labor market remains liberalized. Weak unionization in the region supports the maintenance of liberalized labor market. At the same time, liberalized labor market is an obstacle for the strengthening of trade unions. Domestic economies have remained underdeveloped compared to foreign-owned firms, and this underdevelopment has resulted in lower productivity. The activities at foreign companies belong to the elements of lower added value of global value chains. These factors and low wages allow for a relatively low level of investment in education and social services. These circumstances not only are far from the idea of European social market economy but also limit the development of research and innovation and knowledge-based economy, which perpetuates the asymmetric interdependence on North-Western European and other highly developed countries.

There is an increasing agreement in the literature that this model has limited convergence potential. To maintain long-term convergence, it is essential to reach a better position in global value chains, develop a competitive domestic economy, innovation, and education systems, and enhance governance capacity [cf. e.g. Epstein, 2014; Gräbner et al., 2018; Grieveson et al., 2018].

4 The narrative of "in-betweenness"

Since the systemic change in 1989–1990, the CEE countries have achieved successful political and economic integration in the EU and the globalized world economy, reaching substantial economic convergence to the old EU member states. Therefore, the fierce debates over migration policy in 2015 were unexpected. Although the positions of the CEE countries were somewhat diverse, very deep differences in attitudes and values have been revealed between East and West concerning nation state, the multicultural society, etc. Despite their macroeconomic stability, the political elites which dominated the two decades after the systemic change lost their strong social support in Visegrád countries. In Poland, the Law and Justice Party won the elections in 2015. In the Czech Republic, the populist billionaire's party won the parliamentary election in 2017. In Slovakia, the murder of an investigative journalist and corruption scandals sparked mass demonstrations and Prime Minister Fico resigned in early 2018. However, the most radical change happened in Hungary, which has become the black sheep of the EU from the forerunner of the Western-type political and economic reforms earlier. In addition, the same politician, Viktor Orbán played a prominent role in both periods. These processes in Hungary motivated social scientists to seek a broader, historical context, a kind of "narrative" to explain the development since the systemic change.

Csizmadia [2017] discovered similarities in the political structure and thinking between the turn of 19th century and contemporary Hungary. Hadas [2017] pointed out the similarities and continuities in the delayed and often interrupted processes of Hungarian modernization in the late 19th and over the 20th centuries. Capitalist modernization was transmitted by a foreign bourgeoisie (Jewish and German), and it was no time for other social groups to learn the norms and attitudes complying with market economy and democracy due to the World Wars and the series of systemic changes.

Farkas and Máté-Tóth [2018] investigated the recent East–West rift over migration at the EU level. They suggested that the interaction of socioeconomic and historical reasons resulted in the values and attitudes which are diverging from the Western ones. On the one hand, the above-described model of capitalism could not fulfill the exaggerated expectations connected to capitalist transformation, which hoped a quick convergence to the living standards of the countries such as Germany and Austria. On the other hand, CEE societies have had to form a new societal identity after the collapse of communist regime. Deep traumas, horrors of genocide which permeate not only their history but their memory, play a decisive role in the formation of their societal identities. Recession caused by transformation, rapid changes in sociopolitical circumstances triggered further shocks in the region, from which particularly the losers of the systemic change suffered a lot. As a result of different traumas, woundedness has become a crucial factor of identity, and victimization is a widespread phenomenon (i.e., people regard themselves as victims). The severity of these problems is different within the region according to their experiences, e.g., whether they built a new nation state successfully (the Baltic states or Slovakia) or suffered from a war in the 1990s (the Balkan Wars).

The abovementioned interpretations rely on the essay by Hungarian historian Jenő Szűcs on "The Three Historical Regions of Europe" [1983] known in Poland at that time. He described the region between the Baltic and Adriatic as "the lands in between", that is, between the zones of Western and Russian expansion since the Middle Ages. In their cultural and civilizational orientation, "these lands in between" were formed by Western Christianity and followed Western cultural and institutional patterns. He stated that the development of feudal structures, which took place in Western Europe over 500 years, was achieved in East Central Europe over 150 years. The consequence was a nonorganic development with hybrid, less sophisticated institutions and structures (fewer cities, less liberty, smaller wealth, weaker social contracts, etc). The idea that the multiple routes of modernity are connected to historical regions of Europe still lives on [cf. Delanty 2012].

The concept of "in-betweenness" is very instructive if we examine the model of capitalism in CEE, because this warns of the risk of path dependency. The pattern of FDI-based modernization and asymmetric interdependency fit the traditional relation between Western and CEE countries. The historical legacy of the region does not support the change of this model to knowledge-based economy with more symmetrical interdependencies. The historical development path does not mean determination, but in policy formation the historical legacy must be kept in mind. An aging society, population loss, and the impending fourth technical revolution trigger external shocks for the current CEE model. The responses of the countries will decide whether they strengthen their path dependency or create a new path.

5 Conclusion

Institutional analysis is very fruitful to assess the development opportunities and risks of economies. In the case of CEE countries, institutional comparison contributes to the explanation of their successes and shortcomings in economic convergence to Western European countries and their position within the EU. Interdisciplinary approach may deepen the understanding of possible future policy options. However, these advantages can be obtained if a combination of quantitative and qualitative methodology is used.

In the classification of economies and model building, the conceptually sound choice of wide range of indicators is decisive. Despite the most careful collection of data, empirical investigation may leave important relations undiscovered. For example, the set of indicators which is usually applied in product markets do not contain the composition of foreign capital, that is, the share of FDI and portfolio investment, the ratio of tradable and non-tradable goods, and the impact of global value chains. Disregarding these data hinders understanding why economic performance has been so different in the Mediterranean and the CEE countries since the global crisis in spite of some institutional similarities between them. Macroeconomic examinations and case studies may reveal relations or new indicators which should be incorporated in empirical investigation on the one hand and highlight the casual mechanism behind the indicators on the other hand. Furthermore, changing economic, technical, demographic, etc. circumstances requires the continuous revision of analysis.

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